Demystifying Schuldschein/NSV

Financial Markets Legal Update Seminar 2019

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23 May 2019
Topics

- Schuldschein
  - What is a Schuldschein?
  - Parties to a Schuldschein

- NSV
  - What is an NSV?
  - Parties to an NSV

- Execution and timing

- Regulatory aspects

- Listing / Secondary trading / Accounting

- Investment restrictions

- Overview

- Digression: LMA Schuldschein Template
Schuldschein

What is a *Schuldschein*?

- Certificate of Indebtedness (*Schuldschein*)
  - it is merely a receipt, not a security
  - evidences the lender’s rights under an underlying (bilateral) loan agreement (*Schuldscheindarlehen* – „SSD“)
  - unilaterally issued by the borrower
  - rights under the loan agreement enforceable without presentation and surrender of the *Schuldschein*
Schuldschein

What is a *Schuldschein*?

- Assignable Loan Agreement (*Schuldscheindarlehen* – „SSD“)
  - Form:
    - typically in writing; oral (evidenced by the *Schuldschein*) is sufficient
  - Documentation:
    - in Germany typically a few pages long containing the commercial terms of the agreement
    - LMA Schuldschein Template
  - Amendments:
    - agreement between the borrower and all lenders required
    - German Bond Act (*Schuldverschreibungsgesetz* – „SchVG“) does not apply
Schuldschein

What is a *Schuldschein*?

- German Civil Code (*Bürgerliches Gesetzbuch* - „BGB“) applies:
  - § 314 BGB
    termination right of either party without notice for „good cause“ (*aus wichtigem Grund*)
  - § 489 para. 1 BGB
    termination rights of the borrower for fixed rate notes under certain circumstances (in any event after 10 years) and for floating rate notes with three months notice
  - § 490 BGB
    early termination right of the lender if the borrower’s financial circumstances deteriorate materially
Schuldschein

What is a Schuldschein?

- Transfer:
  - Assignment (Abtretung)
    - valid without consent of the borrower
    - § 354a German Commercial Code (Handelsgesetzbuch – „HGB“)
    - original lender remains party of the SSD (information rights)
  - Assumption of contract (Vertragsübernahme)
    - entire contractual relationship is transferred
    - tripartite agreement – consent of borrower required
Schuldschein

Parties to a *Schuldschein*

- **Issuer / Borrower**
  - banks
  - larger corporations
  - public authorities

- **Investor / Lender**
  - banks
  - insurance companies
  - investment funds
  - pension schemes

- **Registrar**

- **Paying agent**

- **Arranger / settlement agent / broker**
NSV

What is an NSV?

German law governed registered notes (*Namensschuldverschreibungen* – „NSV“)

- **Form**
  - not the same as registered bonds/notes in the UK
  - not securities within the meaning of the Prospectus Directive
  - securities according to the BGB (more specific: „securities in a broader sense“)
  - evidenced by a certificate drawn up in the name of the investor
  - basic principles in the BGB (e.g. § 314 BGB applies) but no specific regime
  - collective safe custody
    - generally (-)
    - global (registered) note possible, provided that such global note is drawn in the name of a central depository
NSV

What is an NSV?

- **Documentation**
  - (sales) prospectus required according to the German Capital Investment Act (Vermögensanlagengesetz – „VermAnlG“) if publicly offered
  - private placement exemptions available, e.g.:
    - „institutional investors“
    - minimum denomination of EUR 200,000
  - Terms & Conditions similar to bearer bond, however differences in:
    - form and transfer
      - assignment
      - minimum transfer amount
      - issuance of new certificates in case of partial transfer
NSV

What is an NSV?

➢ payments
  ▪ may only be claimed by person whose name is in the register
  ▪ at maturity, only upon surrender of the certificate
  ▪ generally no clearing – payments directly from paying agent to investor

➢ counter claims
  ▪ restrictions regarding set-off rights due to investors in Germany often holding NSV in restricted pool of assets (guarantee assets (Sicherungsvemögen))
  ▪ same applies for SSD
NSV

What is an NSV?

- Amendments
  - consent between issuer and all investors
  - SchVG does not apply, unless NSV is evidenced by a global note drawn in the name of a central depositary (see above)

- Transfer
  - assignment (Abtretung) only
  - no in rem transfer of the certificate required (but right to request certificate)
  - without consent of the issuer
  - § 354a HGB
NSV

Parties to an NSV

- Issuer
- Investor
- Arranger / dealer
- Registrar
- Paying agent
- Calculation agent
Execution and timing

SSD/NSV

- often executed orally or on the basis of a term sheet
- exchange of trade confirmations
- SSD/NSV documentation (including certificate) usually follows 2 – 3 weeks later

Sample procedure for a bank acting as settlement agent:
  - term sheet
  - trade confirmation of the investor/issuer
  - „Bi-Party“ Agreement between settlement agent and investor/issuer
  - SSD/NSV documentation
  - settlement
  - physical delivery of SSD/NSV documentation
Regulatory aspects

SSD/NSV

- German Banking Act (*Kreditwesengesetz* – „KWG“)
  - SSD/NSV issuance may be qualified as banking business
    - deposit taking business for the issuer/borrower (NSV is not bearer bond!)
    - lending business for the investor
  - banking business or financial services in Germany generally require banking licence if
    - commercially (*gewerbsmäßige*) or
    - on a scale which requires a commercially organised business undertaking (*kaufmännischer Geschäftsbetrieb*)
Regulatory aspects

SSD/NSV

NB: quite strict interpretation by BaFin

- commercially (gewerbsmäßig)
  - if permanent in nature with the intention of profit making
- on a scale which requires a commercially organised business undertaking (kaufmännischer Geschäftsbetrieb)
  - lending business if more than 100 loans or more than 20 loans with a total notional amount > EUR 500,000
  - deposit taking if more than 25 deposits or more than 5 deposits with a total notional amount > EUR 12,500

- MiFID 2
  - NSV generally (+) except for senior fixed rate NSVs issued by German CRR credit institutions
  - SSD (-)
Listing / Secondary trading / Accounting

SSD/NSV

- Listing
  - no exchange trading on German stock exchanges

- Secondary trading
  - usually „buy and hold“ instruments
  - no liquid secondary market
  - sometimes traded OTC due to easy transfer of claims
  - FinTechs and Hamburg Stock Exchange try to establish some type of secondary market

- Accounting
  - no mark-to-market valuation required
  - valuation at face value
Investment restrictions

SSD/NSV

- German credit institutions and financial institutions (-)

- German institutional investors (+)
  - insurance companies and pension funds may only grant or acquire SSD/NSV to EU corporates with respect to their guarantee assets (Sicherungvemögen) if the borrower fulfils certain criteria resulting in a safe and sound investment (e.g. appropriate credit rating, security...etc.)
  - insurance companies are permitted to invest their guarantee assets (Sicherungsvermögen) into SSD/NSV borrowed by EU credit institutions, EU governments or other acceptable sub-governmental public bodies located in the EU
  - investment funds within the scope of the German Investment Code (Kapitalanlagegesetzbuch – „KAGB“) must not grant any loans to third parties, however, under certain exemptions they are allowed to purchase SSD/NSV
## Overview

### Comparison between *Schuldschein*, NSV and bearer bond/security

<table>
<thead>
<tr>
<th></th>
<th>Schuldschein / SSD</th>
<th>NSV</th>
<th>Bearer bond/security</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legal nature</strong></td>
<td>document evidencing a loan – not a security</td>
<td>security in a broader sense</td>
<td>security</td>
</tr>
<tr>
<td><strong>Enforceability of rights</strong></td>
<td>without presentation and surrender</td>
<td>without presentation and surrender</td>
<td>upon presentation and surrender</td>
</tr>
<tr>
<td><strong>Transfer</strong></td>
<td>generally by way of assignment</td>
<td>generally by way of assignment</td>
<td><em>in rem</em> transfer, i.e. upon agreement and „delivery“</td>
</tr>
</tbody>
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# Overview

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<tbody>
<tr>
<td>Amendments</td>
<td>agreement between borrower and all lenders</td>
<td>consent of all holders required</td>
<td>consent of all holders required</td>
</tr>
<tr>
<td>Application of SchVG</td>
<td>No</td>
<td>No/Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Listing possible</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Clearing</td>
<td>No</td>
<td>No/Yes</td>
<td>Yes</td>
</tr>
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Digression: LMA Schuldschein Template

LMA Template

- **Aim**
  - Making market entry easier for non-German market participants
  - Setting standard in a largely individual market
  - Setting the scene of automation and (later) transformation into smart contracts
  - Enabling a functioning secondary market (platform eligibility)
Digression: LMA Schuldschein Template

LMA Template

- Working assumptions
  - Borrower is a German law private entity
  - Agreement is governed by German law
  - Denomination in EUR
  - Borrower has investment grade rating or equivalent credit standing
  - Terms are negotiated individually (no general terms of business)
  - Granting of loan is permitted from a regulatory point of view
  - Paying Agent located in Germany
Digression: LMA Schuldschein Template

LMA Template

- **Scope**
  - Interests of borrower and lender are equally weighted
  - Documentation does not include syndicated loan style clauses
  - Ancillary documentation such as paying agency agreement is not contained
  - Specific clauses such as make-whole call provisions are not included but wording is suggested in user‘s guide
  - Downstream guarantee is foreseen as alternative
  - Template is only starting point for the transaction – deviation from template is welcomed
  - Accounting is – absent a functioning secondary market – at face value
Digression: LMA Schuldschein Template

LMA Template

- Certain peculiarities
  - Representations and warranties have been omitted on purpose
  - Covenants have been omitted on purpose
  - Application of lender's general business terms is explicitly excluded
  - Template does not foresee a Schuldschein certificate
  - Transfer is by assumption of contract (*Vertragsübernahme*)
  - Tax gross-up and increased cost clause are foreseen
  - Termination for „good cause“ (*aus wichtigem Grund*)
Digression: LMA Schuldschein Template

Market perception

- Market participants are in a „wait and see“ mode
- LMA wants to review the template after one year
- „LMA seal“ used as marketing tool in non-German transactions
- Use of LMA standard can hardly be seen as being „off market“
Please do not hesitate to contact us should you have any questions!

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